

**Franchise Tax Board****ANALYSIS OF ORIGINAL BILL**

Author: Strickland Analyst: William Koch Bill Number: SB 464  
Related Bills: See Legislative History Telephone: 845-4372 Introduced Date: February 26, 2009  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Qualified Diesel Particulate Matter Reduction Property Credit

**SUMMARY**

This bill would allow a tax credit equal to 5 percent of the amount paid or incurred for qualified diesel particulate matter property, as specified, not to exceed \$10,000.

**PURPOSE OF THE BILL**

According to the author's office, the purpose of this bill is to help offset expenses incurred by taxpayers subject to diesel particulate matter reduction requirements.

**EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009, and before January 1, 2019.

**POSITION**

Pending.

**SUMMARY OF SUGGESTED AMENDMENTS**

Amendment 1 is provided to correct a technical error.

**ANALYSIS**FEDERAL/STATE LAW

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in the production of income or property used in a trade or business. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles, and buildings, but excludes land. Significant improvements to property are added to the basis of the property and are depreciated over the property's remaining useful life.

Board Position:

\_\_\_\_\_ S \_\_\_\_\_ NA \_\_\_\_\_ NP  
\_\_\_\_\_ SA \_\_\_\_\_ O \_\_\_\_\_ NAR  
\_\_\_\_\_ N \_\_\_\_\_ OUA \_\_\_\_\_ X PENDING

Department Director

Date

Selvi Stanislaus

05/05/09

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current state and federal laws lack provisions that provide a credit similar to the credit this bill would allow.

Under current state law, for taxable years beginning on or after January 1, 2008, and before January 1, 2010, the total of all business credits otherwise allowable may not exceed 50 percent of the net tax of the taxpayer for that taxable year. Taxpayers with net business income of less than \$500,000 are excluded from this limitation.

In addition, current state Corporation Tax Law (CTL) allows the assignment of certain credits to taxpayers that are members of a combined reporting group and adds the following provisions:

- Provides that an “eligible credit” may be assigned by a taxpayer to an “eligible assignee.”
  - “Eligible credit” means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, which is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after July 1, 2008.
  - “Eligible assignee” means any “affiliated corporation” that is a member of a combined reporting group at certain specified times.
  - “Affiliated corporation” means a corporation that is a member of a combined reporting group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer’s original return for the taxable year in which the assignment is made.

### THIS BILL

This bill would allow a credit under Personal Income Tax Law and CTL equal to the lesser of \$10,000 or 5 percent of the amount paid or incurred during the taxable year by a qualified taxpayer in connection with the purchase of qualified property.

This bill would define a “qualified taxpayer” as a taxpayer who owns vehicles in a fleet or leases vehicles in a fleet for a period of one year or more, pursuant to a written lease agreement.

This bill would define “qualified property” as tangible personal property used by a qualified taxpayer to meet the diesel particulate matter reduction requirements under specified regulations established by the California Air Resources Board (CARB).

This bill would also do the following:

1. Define “fleet” as all off-road vehicles and engines owned or possessed by a qualified taxpayer that are operated within California and are subject to diesel particulate matter reduction requirements established by CARB.
2. Define “diesel particulate matter” as the particles found in exhaust of diesel-fueled compression ignition engines.
3. Require a qualified taxpayer to obtain a certification letter from CARB, and provide it to the Franchise Tax Board upon request.
4. Allow a qualified taxpayer to carry over unused credits indefinitely, until exhausted.
5. Apply to taxable years beginning on or after January 1, 2009, and before January 1, 2019, and be repealed as of January 1, 2019.

Because this bill does not indicate otherwise, the credit provided by this bill would be subject to the 50 percent limitation for the 2009 taxable year and could be assigned to other members of a combined reporting group.

#### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

It is unclear if the \$10,000 maximum credit this bill would allow is per taxable year, per vehicle, or per taxpayer. It is recommended the author amend the bill to clarify this issue to ease the administration of this bill and prevent disputes between the department and taxpayers.

This bill would allow a credit for the purchase of “qualified property”. The bill does not explicitly require a taxpayer to install the property on an off-road vehicle owned or leased by the taxpayer. This bill also fails to require a taxpayer to own and use the property for a specified period of time. It is recommended the author amend the bill to resolve this issue to ease the administration of this bill and prevent disputes between the department and taxpayers.

#### TECHNICAL CONSIDERATIONS

This bill specifies a repeal date of January 1, 2019. The provisions in this bill are for taxable years beginning before January 1, 2019. To retain the provisions "in law" for taxpayers with a fiscal year until the day after the last day of their taxable year beginning December 1, 2018, the repeal date should be December 1, 2019. Amendment 1 is provided to correct this error.

## LEGISLATIVE HISTORY

SB 462 (Strickland, 2009/2010) would allow a tax credit of \$10,000 for a taxpayer who manufactures diesel emission control strategies. SB 462 bill is currently in the Senate Revenue and Taxation Committee.

## BACKGROUND

In 2000, CARB established California's Diesel Risk Reduction Plan to reduce diesel emissions to 85 percent below 2000 levels by 2020. Affected vehicles include bulldozers, forklifts, and many other off-road diesel vehicles. The requirements and deadlines vary by fleet size; large fleets were initially required to begin complying by 2010. As explained in the Revenue Discussion below, ABX2 8 (Nestande, Stats. 2009, Ch. 6), modified the compliance date for diesel emission reduction.

## OTHER STATES' INFORMATION

*Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws do not provide a credit comparable to the credit that would be allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

## FISCAL IMPACT

If this bill is amended to resolve the implementation considerations identified, implementation of this bill would not significantly impact the department's costs.

## ECONOMIC IMPACT

### Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of SB 464 As Introduced 02/26/09 (\$ in Millions)		
2009/10	2010/11	2011/12
No impact	No impact	-\$7.5

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

### Revenue Discussion

The revenue impact of this bill would be determined by the cost of qualified property to reduce diesel particulate matter that is purchased for off road vehicles and engines subject to the diesel particulate matter reduction requirements established by CARB, and the amount of credits applied to reduce tax liabilities. This estimate assumes that only eligible costs for the purchase of filters would constitute qualified property. But the bill is drafted more broadly to include any "tangible personal property that is used to meet the diesel particulate matter reduction requirements."

ABX2 8 (Nestande, Stats. 2009, Ch. 6), modified the compliance date that off road vehicles must meet diesel emission reduction requirements to 20 percent compliance in 2011, 20 percent in 2012 and 60 percent in 2013. Per CARB, fleet owners and rental or leasing companies will not incur the costs to modify the vehicle or engines until mandated to do so.

CARB estimates California has 35,000 off road vehicles and engines that will require retrofitting to meet the diesel particulate matter reduction requirements.<sup>1</sup>

The cost of retrofitting a diesel particulate fuel filter is between \$10,000 and \$20,000 per vehicle or engine.

Assuming an average cost of \$15,000 per qualified vehicle or engine, each filter would generate a credit of \$750 ( $\$15,000 \times 5\%$ ). Based on the compliance rates established by ABX2 8 (Nestande, Stats. 2009, Ch. 6), 20 percent of the 35,000, or 7,000, vehicles or engines would be retrofitted in 2011 generating credits of \$5.2 million ( $7,000 \times \$750$ ). It is estimated that 90 percent, or \$4.7 million ( $\$5.2 \text{ million} \times 90\%$ ) of the credits would be applied in the year generated and the remaining 10 percent, or \$500,000 ( $\$5.2 \text{ million} \times 10\%$ ) would be carried over and applied to reduce tax liabilities in the second year.

Taxable year estimates are converted to fiscal year cash flow estimates in the table. The first fiscal year loss in 2011/12 of \$7.4 million, rounded to \$7.5 million, is a result of the 2011 credit utilization of \$4.7 million and reduced estimated tax payments (\$2.7 million) for the subsequent tax year.

## **ARGUMENTS/POLICY CONCERNS**

Conflicting tax policies result when a credit is provided for an item that is already deductible as a business expense or is depreciable (double tax benefit). On the other hand, making an adjustment to reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

This bill allows the credit in the taxable year in which the qualifying property is purchased, which may be earlier than the taxable year in which the qualifying property is actually placed in service (i.e., used) in California. Most credits involving the acquisition and subsequent use of property require the credit to be claimed in the taxable year in which the placed in service date, for depreciation purposes, occurs. It is possible that a taxpayer could purchase the equipment, claim the credit, and resell the equipment to a third party that may also claim the credit. If this bill were to require that the equipment be placed in service in California, with an appropriate recapture provision to ensure continued operation in California for a specified (recapture) period, this potential problem would be avoided. The recapture provision would require the taxpayer to use the equipment for a certain length of time in this state or add all or some portion of the credit amount back to the tax liability.

---

<sup>1</sup> Cal. Code of Regulations, Title 13, Section 2449

Additionally, this bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

#### **LEGISLATIVE STAFF CONTACT**

Legislative Analyst  
William.Koch  
(916) 845-4372  
[william.koch@ftb.ca.gov](mailto:william.koch@ftb.ca.gov)

Revenue Director  
Jay Chamberlain  
(916) 845-3375  
[jay.chamberlain@ftb.ca.gov](mailto:jay.chamberlain@ftb.ca.gov)

Asst. Legislative Director  
Patrice Gau-Johnson  
(916) 845-5521  
[patrice.gau-johnson@ftb.ca.gov](mailto:patrice.gau-johnson@ftb.ca.gov)

Analyst	William Koch
Telephone #	845-4372
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 464  
As Introduced February 26, 2009

AMENDMENT 1

On page 3, line 1, and page 4, line 10, strikeout "January" and insert:  
December